

Bert's Boots

Nicole Neville answers a request for advice on the disposal of a company and provides some exam tips at the same time.

As, I suspect, for many *Taxation* readers, my relatives seem to think that I am a ready supply of tax advice and planning ideas. Sometimes I wonder how they arrived at that conclusion, until I remember that it was probably because I am always happy to supply tax advice and planning ideas. Little do they know that I am keeping timesheets for each of them...

It is usually at family gatherings that I am tapped up for information – in fact, now I think of it, I am starting to wonder whether it is just a coincidence that many of these events take place soon after the annual budget, before the tax return filing deadline and around the end of the tax year.

Anyway, there is no time to think of that now because I have just received the latest request, which this time came in the form of an email from great uncle Bert and which, in the subject line, was entitled ‘Tax advice on the disposal of my company’.

‘Hi Nicole,

‘I trust all is well with you in the tax tutoring world. I was hoping you could give me some tax advice...

‘As you know, my company “Bert’s Boots Ltd” has been doing tremendously well lately and is striding ahead of the competition. So much so, I just had a phone call from a footwear retailer, “Funky Footwear Ltd”, offering to buy my shares in the company. I suppose they think it would be a good *fit* (get it?).

‘My doctor did suggest recently that I should consider slowing down, my role as chief executive officer can be quite stressful. So perhaps I should consider kicking back in my retirement and taking up the offer. In the circumstances, I thought I’d better step on it.

Key points

- Sole shareholder and director will sell trading company shares.
- Sketch out a plan of the steps and the tax matters to be considered. Who is the exam answer being written for?
- Does the company own non-business assets?
- The conditions for capital gains tax entrepreneurs’ relief.
- Shares in an unquoted trading company are eligible for holdover relief, but are all its assets used for business purposes?
- Summarise action points and deadline dates.



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‘Can you advise me of the capital gains tax consequences? I’d hate to think of HMRC putting the boot in, so if there are any reliefs I can claim please do let me know.

‘Let me give you some information about my business. I started the company in 1984 when I subscribed for 100% of the shares for £100 and the offer I received from Funky Footwear Ltd was for £750,000. The balance sheet for my company at December 2018 is:

	£
Premises	800,000
Fixtures and fittings	4,000
Car	3,000
Shares in BT plc	15,000
Stock	17,000
Cash	<u>1,000</u>
Total	<u>840,000</u>

‘I think that’s all the relevant information. I trust you will make suitable assumptions should you need to.

‘All the best; your loving uncle Bert

‘PS: I did have another idea, maybe I should consider giving the shares to your brother Bob. He has been doing some work for me on a part-time basis and has really impressed me. With his management skills I think he’d be a shoe-in for the role of CEO. He probably wouldn’t want me around stepping on his toes, but it would be nice to keep the business in the family.

‘PPS. Just a thought... I presume there would be no capital gains tax liability if I give the shares away?

‘PPPS. If you can reply by email that would be great.

‘PPPPS. There’s a free pair of boots in it for you.’

The big question

Dear old great uncle Bert. I am so delighted he received such a good offer for his company, and only slightly disappointed that he overlooked me when he was considering keeping the company in the family.

I sat at my computer poised to respond to his email when it occurred to me that this scenario would be a perfect ATT paper 1 exam question. All it needs is a requirement at the end; perhaps something along the lines of: 'You are required to write an email responding to great uncle Bert's queries.'

So, with Bert's kind permission, let me take the opportunity to give him the tax advice he is requesting and also give you, dear readers, some advice on how to stay on your toes and approach a question such as this if it were to appear in your ATT paper 1 exam. There are three basic principles to remember.

- **Ensure your answer is in the correct format.** The requirement is asking for an email, so I will make sure to do just that.
- **Know who you are addressing your answer to.** I will be writing to great uncle Bert – a layperson. He is not a tax expert, so I must make sure I explain things in such a way that he can understand.
- **Prepare a brief plan.** This can be done during the 15-minute pre-exam reading time, as annotations on the side of the question. I will identify the key issues that I plan to address in my answer.

Focusing on the third point above, the plan, I will consider several steps.

- First, the sale of the shares to Funky Footwear; there will be a capital gain arising. Great Uncle Bert has steered me towards suggesting any tax reliefs that might be available. I will advise him that he can claim entrepreneurs' relief.
- Second, I will consider the gift of the shares to Bob. Great Uncle Bert is convinced that there will be no capital gains tax consequences because he is giving the shares away. Is he right? We have already established that Bert is not a tax expert, so we should be sceptical about his presumptions.
- Third, I will advise Bert that a gain will arise, using the market value of the shares as proceeds.
- Finally, I will explain that gift relief is available.

So, in summary, my brief plan scribbled in the margin of the imagined exam paper looks like this:

- Capital gain on sale to Funky Footwear.
- Entrepreneurs' relief.
- Capital gain on gift to Bob.
- Gift relief.

This plan gives a structure to my answer that I can then polish. I will make sure to follow this structure using the points in my plan as my headings.

Great Uncle Bert has provided enough information to prepare supporting computations to the advice I give him. So, I should do exactly that. Because I feel quite confident doing the computations, I might do these first and then add them as an appendix to my email. But I must remember to refer to these in the body of my email.

The exam answer

Let's get started on the answer. I will try to keep my sentences precise and concise and my paragraphs short. That way the marker can easily identify the points I am making and award credit. I have added some relevant thoughts that support my deliberations in square brackets.

Email from: Great niece Nicole

To: Great uncle Herbert

Subject: Tax advice re disposal of your company

Hello great uncle Bert.

Thank you for your email requesting tax advice on your disposal of shares in Bert's Boots. [In real life, I would be a little more chatty, perhaps share some family news with him. But in the exam, a one-line introduction is sufficient.] I have set out the main considerations below.

Capital gain on sale to Funky Footwear

If you choose to sell the shares in your company to Funky Footwear, a capital gain of £749,900 will arise based on the difference between the proceeds and cost.

“Whenever you write about a capital gains tax relief it is important to explain the conditions that need to be met for the relief to apply.”

[Did you spot great uncle Bert's suggestion that I make suitable assumptions should I need to? Here is my first.]

Assuming this is the only chargeable disposal that you make in the tax year, you will be entitled the full annual exempt amount of £11,700, resulting in a taxable gain of £738,200. See **Appendix 1**.

Assuming you are a higher rate taxpayer, this gain would be subject to capital gains tax at 20%. [That was my second assumption. Because he is CEO of his company, I think it is reasonable to assume he is a higher rate taxpayer.]

Entrepreneurs' relief

This gain will be eligible for entrepreneurs' relief. This will reduce the capital gains tax rate to 10%. [Whenever you write about a capital gains tax relief it is important to explain the conditions that need to be met for the relief to apply. It is not necessary to memorise these conditions, the legislation can be used to help (TCGA 1992, s 169I).]

Entrepreneurs' relief is available if three conditions are met during the 12-month period before disposal.

Appendix 1

Sale of shares to Funky Footwear

	£
Proceeds	750,000
Less: cost	<u>100</u>
Chargeable gain	749,900
Less: annual exemption	<u>11,700</u>
Taxable gain	<u>738,200</u>
Capital gains tax @ 10% (entrepreneurs' relief)	<u>73,820</u>

Appendix 2

Gift of shares to Bob

	£
Proceeds = Market value	750,000
Less: cost	<u>100</u>
Chargeable gain	749,900
Gain eligible for gift relief:	
$749,900 \times 800,000 / (800,000 + 15,000)$	<u>736,098</u>
Chargeable gain	13,802
Less: Annual exemption	<u>11,700</u>
Taxable gain	<u>2,102</u>
Capital gains tax @10% (entrepreneurs' relief)	<u>210</u>

- The shares are in a company in which you have at least 5% of the ordinary shares and votes.
- You must be an employee of the company.
The company must be a trading company.

[Then, most importantly, we need to apply these conditions to the scenario.]

“Because entrepreneurs' relief is only available if a claim is made it is always a good idea to state the date by which the claim must be made.”

All these conditions will apply to you. You have owned 100% of the shares since 1984. As the CEO, you are an employee of the company which trades as a shoe retailer.

A claim for entrepreneurs' relief must be made by 31 January following the tax year of disposal. [Because entrepreneurs' relief is only available if a claim is made it is always a good idea to state the date by which the claim must be made and make sure this is applied to the exam scenario.]

So, if you sell the shares in the tax year 2018-19, the claim must be made by 31 January 2021.

Capital gain on gift to Bob

You mentioned that as an alternative you were considering giving the shares to Bob. [Now let's take the opportunity to – politely – correct Great Uncle Bert's presumption.]

Even though you will receive no consideration for the shares, there will still be a chargeable gain. This will be calculated using the market value of the shares as if this was the sale proceeds.

We can assume that the market value of the shares is £750,000 because that is what an unconnected third party (Funky Footwear) is prepared to pay. So, the chargeable gain will be £749,900. See *Appendix 2*.

Gift relief

This gain on the gift of shares to Bob will be eligible for relief because you are gifting a qualifying asset, namely shares in an unquoted trading company. [Remember, gift relief is not available on the gift of *any* asset, it must be a qualifying one. Again, you don't need to memorise which assets qualify for gift relief, they can be found in the legislation, listed in TCGA 1992, s 165.]

Because you will be receiving no consideration for the shares, you would expect to be able to defer the entire gain.

[The examiner tends not to give extraneous information. So, if the question includes an extract of the balance sheet of his company, think about the relevance of this information to the scenario. Note that one of the assets on the balance sheet is shares. These are not business assets. This will affect the amount of the gain that qualifies for relief.]

However, if the shares are the subject of a gift relief claim, we need to consider whether the company owns any non-business assets – such as an investment property or an investment portfolio of shares. If it does, the gain eligible for relief will be restricted by applying the following fraction to the gain: chargeable business assets/total chargeable assets.

The chargeable assets

The chargeable assets in the company are those that are chargeable to capital gains tax, whereas the chargeable business assets are those used for a business purpose.

[Let's go through the items listed in the balance sheet and identify whether these are chargeable assets and, if so, whether they are also chargeable business assets.]

- Land and buildings are subject to capital gains tax, so the premises will be a chargeable asset. Because they are used for a business purpose, they will also be considered to be chargeable business assets.
- The fixtures and fittings are unlikely to be chargeable assets. [This is another assumption. I have assumed that the original cost of each of the items of fixtures and fittings was less than £6,000.] They are currently valued at £4,000 and will probably be treated as exempt under the chattels rules in TCGA 1992, s 262. This is because no gains or losses arise if a chattel costing not more than £6,000 is sold for proceeds not exceeding £6,000.
- The car is an exempt asset for capital gains tax.
- The shares in BT plc are chargeable assets. However, they are not business assets because they are held as an investment – to generate dividend income rather than trade profits.
- Stock and cash are not chargeable assets for capital gains tax – if a company sells stock it generates trading profits rather than a capital gain. So, these items cannot be chargeable business assets.

The chargeable gain

The total value of the chargeable assets is therefore the value of the premises, plus the shares. These add up to £815,000. The only chargeable business asset is the premises with a value of £800,000.

So, the gain that can be deferred by way of gift relief is £736,098, being $£749,900 \times 800,000 / 815,000$. This leaves £13,802 chargeable, being £749,900 less £736,098.

As explained above, I am assuming the full annual exempt amount of £11,700 is available and the rate of capital gains tax will be 10% because you can claim entrepreneurs' relief in respect of the remaining gain. This means you will have a liability of £210 – being £2,102 (£13,802 – £11,700) at 10%.

[There will be no additional marks allocated in the marking guide for re-stating the conditions for entrepreneurs' relief because I have already detailed them earlier. So, I will make sure not to repeat myself.]

Please note that gift relief is a deferral relief, the effect of such a claim is to reduce the base cost of the gifted asset by the amount of the gain deferred.

[That's the theory, now I will relate it to the scenario.]

This means that, for Bob, the base cost of the shares for any subsequent disposal by him will be the market value at the date of the gift (£750,000) less the deferred gain (£736,098). So when he disposes of the shares the base cost in his calculation of the gain will be £750,000 – £736,098 = £13,902. In effect, the gain that you deferred will be chargeable on Bob when he disposes of the shares.

The admin matters

[And now follow the all-important administrative points.]

For gift relief to be available, you and Bob will need to make a joint claim. In other words, you must have Bob's consent because, ultimately and as mentioned above, the deferred gain will be chargeable on him. This claim must be made within four years from the end of the tax year of the gift. Therefore, if you make the gift in 2018-19, the claim must be made by 5 April 2023.

[I have followed my plan and I have now covered everything that great uncle Bert has asked about. I have also re-read the email and checked that I have indeed used all the information provided. So, all that remains is to conclude the email. Again, in real life, I am likely to be less perfunctory, but in the exam I will conclude as follows.]

Please let me know if you need any further advice.

All the best.

Planning point

A claim to capital gains tax holdover relief must be made within four years of the end of the tax year of the gift. For a gift made during 2018-19, the claim must be made by 5 April 2023.

Conclusion

Before I end this article allow me to highlight a couple more points. First, even though I have suggested that reference should be made to the legislation for the conditions for entrepreneurs' and gift relief, I have not included legislative references in my email to great uncle Bert. This is because, as a non-tax technical person, he is looking for a tax expert (me) to explain things in simple terms. Had I been writing to a tax technical person, a tax partner for example, it would be appropriate to refer to the legislation.

“ Make sure you answer exactly what has been asked for.”

Second, some may be wondering why I have not considered the inheritance tax implications of Bert gifting his shares to Bob because this would be a transfer of value for inheritance tax purposes. The reason for this (aside from it being outside the ATT paper 1 syllabus) is that Bert only asked me to advise him of the *capital gains tax* consequences of his proposed plans. Look carefully at the requirement and make sure you answer exactly what has been asked for. Had he asked me for the *tax* consequences of his proposed plans, I would need to consider all relevant taxes.

Now I have concluded my tax advice to great uncle Bert and my exam technique advice to readers, I think I deserve some retail therapy. Pending the arrival of Bert's boots, I might treat myself to a new pair of shoes. ●

Author details

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